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SUBJECT: WENZHOUE - A CANARY IN CHINA'S ECONOMIC MINESHAFT

REF: 08 SHANGHAI 174

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¶1. (SBU) Summary: During the Deputy Principal Officer's January 21-22 visit to Wenzhou, Zhejiang Province, local officials said Wenzhou was one of the first cities in China to feel the impact of the global slowdown because of its largely private sector economy and heavy reliance on exports. The effect of the slowdown has been dramatic with 10 percent of local businesses going bankrupt. However, the Government is taking active steps to prevent the collapse of big companies and ensure social stability. Foreign Direct Investment (FDI), although somewhat scarce in Wenzhou, has remained stable throughout the economic downturn. A local shoe manufacturer said the effect of the economic slowdown on his firm was negligible because it is more focused on China's internal market. Wenzhou IP Complaint Center officials said the city has come a long way on protecting IP, especially on raising IP awareness. During a visit to the Nanmen Catholic Church, Father Ma Xianshi said the greater metropolitan area with its 120,000 believers is home to the greatest concentration of Catholics in Zhejiang Province. All the Wenzhou interlocutors showed great interest in President Obama's inauguration, discussing in detail his inaugural address and the meaning of his election for China. End summary.

"Where There Are No Wenzhou People, the Market Doesn't Have a Chance"

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¶2. (SBU) In a meeting with Wenzhou Bureau of Foreign Trade and Economic Cooperation (FTEC) officials, Deputy Director Liu Ting explained Wenzhou's diaspora that built a network of businesses around the globe and continues to fuel the city's economy as one of the few sources of FDI. Wenzhou, hemmed in by water and mountains in the southern part of coastal Zhejiang Province, lacks sufficient space (only 10 percent of the land is usable) to grow and prosper, thus driving more than 600,000 people overseas since China's reform began. Describing his fellow Wenzhou citizens, including those overseas and in other Chinese cities, as highly entrepreneurial, Liu said that "where there is economic opportunity, there are Wenzhou people." Liu estimated

that in the United States alone there are close to 100,000 Wenzhounese. As these people left, over 2 million migrant workers from other parts of China have flooded the city, raising the total population of the metropolitan area close to 7.9 million.

13. (SBU) Liu added that Wenzhounese continue to hold up the entrepreneurial spirit with over 60,000 companies registered in the city, 98 percent of which are private enterprises. There are also 170 Wenzhou chambers of commerce - many of which are in China, but some are as far away as South Africa. Liu said that other cities in China pay a great deal of attention to these chambers and their annual joint meeting. The first annual meeting was hosted by Guangzhou, and now many municipal governments want to host the event as a means to attract business and investment. Liu attributed Wenzhou's entrepreneurship to its people's ability to "chi ku" or "eat bitterness" to keep businesses running. Lack of Central Government investment in the Wenzhou area also forced self-reliance. Since China embarked on reform and opening up 30 years ago, total Central Government investment in the city amounts to a mere RMB 600 million (USD 88 million). "People don't wait for or depend on the Government for a hand out" said Liu. (Note: After the KMT's departure to Taiwan in 1949, the Central Government assiduously avoided investing in the coastal area close to Taiwan, assuming it would be the most likely location of any landing by KMT military forces.) The inhospitable business environment, which includes lack of resources, low foreign investment, scarce usable land, and few good transportation links, has also honed Wenzhou people's drive to succeed despite the odds.

#### Trade Falling Off a Cliff

14. (SBU) Wenzhou FTC Chief of Foreign Trade Xia Linhong said Wenzhou was one of the first cities in China to experience a

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sharp reduction in trade as the global economy ebbed and believe it would be the first to see a pick-up when demand resumes. He attributed this to the fact that close to 95 percent of the local economy is tied to trade, and there are virtually no state-owned enterprises to soften the blow. In addition, only 5 percent of Wenzhou's exports are the result of processed imported components. He said as early as January 2008, Wenzhou's trade growth rate had already started to drop below that of other cities in the province. The biggest impact on trade during the first half of 2008 stemmed from higher labor costs resulting from the Labor Contract Law and the appreciating RMB. For the second half of 2008, Xia laid the blame squarely on fluctuating commodity prices and weakening external demand. He added Wenzhou was particularly susceptible to exchange rate shifts because of its specialization in cheap goods that have a small profit margin.

15. (SBU) Although the E.U. is Wenzhou's largest trading partner, the United States is the largest single country with which Wenzhou trades. In 2008, exports from Wenzhou to the United States totaled USD 1.15 billion. Imports from the United States were roughly USD 350 million. Xia noted orders from the United States began dropping sharply as early as September. Some U.S. importers, having already placed orders, demanded that the products not be shipped, which caused a sharp increase in factory inventories. As more customers in the United States go bankrupt, trade financing is increasingly drying up, compounding the problem for Wenzhou exporters. He also expected that export growth would continue to drop significantly through the first half of 2009.

#### Government Taking Firm Measures to Guard Against Social Instability

16. (SBU) Liu believed that "many" Wenzhou factories would close all or part of their capacity after the Lunar New Year.

Approximately 10 percent of all Wenzhou factories had already shut down - but most of these were small and medium size enterprises. Big companies are still operating, which meant there likely would not be problems of social unrest. Liu said the Government is intent on maintaining stability. If a large company goes bankrupt, the Government will step in to liquidate the company's assets to pay wages to employees. The Government is also offering low interest loans to companies that are unable to pay wages. He added that companies are still having trouble obtaining financing from banks despite Government efforts to encourage loans. Regarding migrant workers, Liu said a portion will likely not return after the Lunar New Year. Those that have sufficient funds to build a house in their home village may choose not to come back and face the prospect of not having a job.

#### Not Much Effect on FDI Since Not Much to Begin With

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17. (SBU) Liu said that despite trade problems, the economic crisis has had little impact on FDI since, in Wenzhou, there is little to begin with. Most of the FDI that continues to flow into Wenzhou comes from the pockets of Wenzhou citizens abroad. He said this unabated flow of investment is probably because people do not see better alternatives elsewhere. Furthermore, the vast majority of inbound investment does not flow to businesses, but rather into Wenzhou real estate. Liu was only aware of one U.S. investment in the city, which produces auto parts. There is also little investment from Hong Kong and Taiwan since "there are many other cities in China with better infrastructure to attract their business." However, there is a long history of trade with Taiwan since many Wenzhou residents have relatives on the island, it is close by and Wenzhou dialect, while distinct from, is closer to Minnanhua, the southern Min dialect also known as Taiwanese, than any other dialect.

18. (SBU) Wenzhou investors are increasingly looking to the United States to park their money, according to Liu. He cited as an example General Protect, a Wenzhou company specializing in breakers and switch products, which has committed USD 236 million to build an industrial park in Georgia. With the appreciation of the RMB and decreasing price of assets, the United States has become a real bargain. Wenzhou people are

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particularly looking to snap up real estate in the United States. Wenzhou businesses are also actively investing in other places in China, Shanghai being one of the most favored destinations. He noted that Juneyao Group, owner of China's largest private airline, is one such Wenzhou company that had moved its operations to Shanghai. However, the Wenzhou Government is actively encouraging companies to, at a minimum, maintain their headquarters in the city although branches may be located elsewhere.

#### Vice Mayor Addresses Social Stability and Economic Stimulus

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19. (SBU) In a separate meeting, Wenzhou Vice Mayor Chen Hongfeng echoed the remarks of Liu and Xia about Wenzhou's entrepreneurial spirit and the city's current difficulties. He emphasized Wenzhou plays a more important role in China than most other cities its size because of its trade and business links. Other cities in China have also looked to Wenzhou as a successful model. Wenzhou has particularly benefited from having an open, private sector based economy, and 80 percent of the city's tax revenue comes from the private sector. Wenzhou residents are also among the wealthiest in China, with a per capita GDP of RMB 26,000 (USD 3,800). The city also has trade relations with over 100 countries. Regarding the economic crisis, Chen assured that there has been no social unrest from factory closures and the situation is stable. The Wenzhou Government is also benefiting from the stimulus package through new projects as well as the speeding up of already planned projects. He said, for example, the city is building a new

runway at the airport and upgrading the facility to accommodate international flights. Two new rail lines will also be put into operation in 2009 (one to Ningbo, the northern Zhejiang city that is China's fourth largest seaport, and the other to Fujian Province south of Zhejiang). A deepwater port is also under construction and set to open by the end of 2009.

¶10. (SBU) A number of interlocutors emphasized that the key to Wenzhou's success was the private sector. Government's key contribution, especially at higher levels, was simply to permit Wenzhou entrepreneurs to go about their business. FAO Director Chen Aichen contrasted Wenzhou and its larger rival in Zhejiang, Ningpo, saying that "Ningpo has a rich government but poor citizens, while Wenzhou has a poor government and rich citizens." (Comment: Nevertheless, Wenzhou boasts a new municipal plaza area with a massive government office building, museum, library and opera house, all recently constructed and on a scale that would not be out of place for a city three times its size. End comment.) The Deputy Secretary General of the Municipal Government, Chen Weimin, told us at dinner that he had read a quote from President Reagan's inaugural address that had much impressed him - "government is not the solution to our problems, government is the problem," which, he implied, was a sentiment with which many Wenzhouese would agree.

#### Running Faster with Better Shoes

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¶10. (SBU) During a visit to one of China's largest shoe manufacturers, Kangnai Group Vice Executive General Manager Zhou Jinmiao briefly outlined the history of his private enterprise. He said the company was part of Wenzhou's tradition of making shoes, which the city has done since the Ming Dynasty. Shoe making is also one of the city's few competitive advantages, on which it is so intent to capitalize that Wenzhou has established shoe and clothing design majors in each of its four institutions of higher education. (Note: The Vice Mayor claimed that Wenzhou is the largest shoe manufacturing location in the world.) As for Kangnai, Zheng Xiukang built the company from humble beginnings in 1980 with a loan of RMB 500 from a neighbor. The company is now a behemoth that sells over 9 million pairs of shoes a year in China, North America, Europe, and other parts of the globe. The company had to significantly change its strategy and boost quality through standardization in the 1990s as Chinese became more brand conscious and demanding of quality. The company decided to focus primarily on producing shoes under its own trademark, which it registered in 1992, and now has outlet stores in places such as Manhattan and Paris. Zhou said the shoe market in China, which was an open field of opportunity as China's reform began, has now become a fiercely competitive arena since the entrance of multinationals, so much

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so that it has even been driven out of some of the high fashion malls in Beijing.

#### Economic Downturn Not Taking the Bounce Out of These Shoes

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¶11. (SBU) According to Zhou, Kangnai has been relatively unscathed thus far by the global economic downturn, primarily because the company chose to focus primarily on domestic demand rather than exports. Other Wenzhou shoe makers that produce primarily under other brand names for exports had not been so lucky. Kangnai chose to focus on China's market because of the potential. "Even the poorest farmer can now afford shoes," said Zhou, and there is a long way to go since the average consumer only buys 1.7 pairs of shoes a year, compared to the average American consumer who buys 7 pairs each year. The only real effect is that Chinese are now shying away from high-end shoes as consumer confidence falls. Cooperation with a Pittsburgh company to open an outlet was also postponed because of the economic downturn. Kangnai, as an unlisted company, relied heavily on bank loans, and despite Chinese banks' tightening of purse strings, was able to still secure loans because of its "good credit record." According to Zhou, the appreciating RMB

gave Kangnai a bit of a boost since the imported leather, and other material from around the world is all the more cheaper.

¶12. (SBU) Zhou expected that most of his 3,000 workers would return after the Lunar New Year holiday. He noted that around half came from Zhejiang Province while the rest hailed from central and southwest China. Zhou supported the Labor Contract Law, saying it was the "right thing" to protect workers, and each of Kangnai's employees has a contract. He added that Kangnai is completely unionized.

#### Wenzhou IPR Protection - in Nascent Stages

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¶13. (SBU) In a meeting with Wenzhou Intellectual Property Rights (IPR) Complaint center officials, Director Dan Shicheng said Wenzhou has its own IP website, under the auspices of a Central Government website, for disseminating information about IP issues in Wenzhou. In total Wenzhou posted 1,371 pieces of information on its website in 2008. The Wenzhou IPR Complaint Center, one of four in Zhejiang Province, has a small staff of three people and has been in existence since August 2006. However, there is no information in English on the website, nor is there any written material in English or English speaking staff at the center. Complaints are handled through the website, as well as over the phone and in person. Dan emphasized that it is mandatory that each complainant "establish his or her identity and show proof of the infringement." Most of the complaints are related to trademarks and trade secrets, and there have been no cases related to foreigners. Dan also noted that cases can be transferred electronically between all complaint centers within China. The center also provides IP-related training to government workers from other bureaus within the Wenzhou Government.

¶14. (SBU) Dan said that Wenzhou has an IP Coordinating Council under the auspices of the Wenzhou IP Administration, which actively coordinates activities between IP bureaus within Wenzhou as well as with IP agencies in other jurisdictions. Wenzhou IP authorities, including the Copyright Bureau, the Public Security Bureau (PSB), and the IP Administration and others have a monthly meeting to coordinate issues. Wenzhou has no IP white paper, but it reports monthly to Hangzhou and provides input into the provincial white paper. The city has an IP tribunal that was established in the 1980s that combines civil and criminal cases. For special cases, the court allows open trials for the public to see. There have been no alleged cases of Internet-related piracy, and there have been few cases related to patents and copyrights. The PSB also has a special unit to deal with IP crimes. (Comment: U.S. companies have been less than impressed by Wenzhou IP protection. Besides basic difficulties getting assistance from local IP authorities, U.S. companies have strongly criticized a September 2007 Wenzhou Intermediate Court ruling against Schneider Electric of France. The Wenzhou Intermediate Court ruled that Schneider infringed against a competing Chinese company to the tune of USD 50 million and was fined an equivalent amount. This is a tremendous sum, especially in comparison with fines imposed on

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Chinese companies for similar infringement. In a separate Wenzhou court case, the American firm 3M also complained of local protectionism when the court ruled documents "invalid," and dismissed the case because the documents did not contain proper notary seals, even though the notary seals were from the Chinese Consulate in Chicago. End Comment.)

¶15. (SBU) FTC Chief of Foreign Trade Xia stressed how far IPR protection has come in Wenzhou in recent years, especially IPR awareness among the general population. The city ensures there is an IP Complaint booth at all trade fairs and the city is pushing for harsh penalties for IP infringement and mandatory confiscation for infringed goods. Wenzhou also makes a special effort to ensure its "48 famous trademarks" are well protected throughout China. He acknowledged, however, there is little cooperation with Customs and PSB on infringement cases.



Kangnai's Zhou said that his company experienced a significant IP problem in 1994, when knock-offs began turning up in market. However, using "legal means" and obtaining good support from the Government, it put an end to the piracy and has not encountered IP problems since.

#### The Parish That Tries to Make a Difference

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¶16. (SBU) During a visit to the Wenzhou Nanmen Catholic Church, the affable Father Ma Xianshi explained how the church tries to make a difference in the daily lives of its 1,200 members through numerous activities and Bible study classes, especially for children and young people. Around 500 people attend services on a regular basis. Father Ma gave high marks to the local government for its support, particularly for providing the land on which the church was built. The building was constructed with funds from local members. He also said the area has the largest Catholic concentration in Zhejiang Province, with over 150 churches and 120,000 believers in the larger metropolitan Wenzhou area. There are only 30 priests, an insufficient amount according to Father Ma, to serve the large number of believers. There are also a few foreigners, mostly Africans, who regularly attended services. Attendance temporarily had jumped after the May 2008 Sichuan quake as more people sought comfort from the church. He said the biggest challenge is reaching an accommodation with "house churches," or adherents of the "underground Church," that is, those Catholics who only recognize Church leaders appointed by the Pope. Ma estimated that there are about 50,000 such people in the Wenzhou area. The church boasted a handsome, framed picture of Pope Benedict on the wall of one of the meeting rooms. When asked about the picture, Father Ma quickly affirmed that the Catholics in China are not subordinate to Rome.

#### Obama on Their Minds

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¶17. (SBU) Throughout the visit, Wenzhou interlocutors repeatedly raised President Obama's inauguration, discussing in detail his inaugural address and the meaning of his election for China. FTEC Deputy Director Liu said his impression of Obama was that he was relatively more protectionist than John McCain and expressed concern about how potential U.S. protectionist policies could hurt China's exports. Vice Mayor Chen said he had seen the inaugural address and was very impressed. He also expressed his desire to see Obama would be able to solve the global economic crisis. Wenzhou Foreign Affairs Office Director Chen Aizhen discussed the inaugural address in great detail, noting that there was little about foreign policy. Even Father Ma commented on the inauguration, saying how he was impressed that the President had used a Bible during the swearing in ceremony.

CAMP